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C O N F I D E N T I A L SECTION 01 OF 02 PRISTINA 000697

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DEPT FOR DRL, INL, AND EUR/SCE, NSC FOR BRAUN, USUN FOR
DREW SCHUFLETOWSKI, USOSCE FOR STEVE STEGER

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SUBJECT: KOSOVO: TREPCA AND THE NEED FOR SOUND ECONOMIC AND
BUSINESS DECISION MAKING

Classified By: COM TINA KAIDANOW FOR REASONS 1.4 (B) AND (D).

11. (C) SUMMARY: In August, the Kosovo Assembly was poised to pass an ill-advised resolution mandating that the debt-ridden Trepca mining and minerals company be designated a publicly-owned enterprise (POE) rather than a socially-owned enterprise (SOE). The move would have been a disastrous one, saddling the Kosovo government with up to a half billion euro worth of debt and international claims against the mining complex from the pre-war era. The resolution was not adopted, following USOP intervention. However, we agree with the Kosovars on one key point: they need a seat at the table when Trepca's future will be determined. Our emerging view is that, through USAID, we should play a role in ensuring that Trepca is privatized in a way that yields the maximum benefit to Kosovo and the Mitrovica region. END SUMMARY.

ONCE PROFITABLE, NOW DEBT-RIDDEN

12. (U) The Trepca conglomerate, an SOE, includes mines, an industrial park in Mitrovica, and the Zvecan smelter complex. It was a major employer in Yugoslavia, with over 20,000 workers at its peak. However, Kosovo Albanian management and workers were expelled in 1988-89, and in the 1990s many plants were closed. Between 1995 and 2000, Serbian General Director Novak Bjelic engaged in a series of questionable financial operations including borrowing against Trepca's assets.

13. (U) Today, Trepca is a decrepit and debt-ridden shadow of its former self. With 5,000 workers - most of them "phantom" employees - it operates at a loss and has drained 70 million euro from the Kosovo budget since 1999. In September 2006, upon application by the Kosovo Trust Agency (KTA), the Special Chamber of the Kosovo Supreme Court approved placing Trepca under Chapter 11-style administration and imposed a moratorium on creditor proceedings against it. The complex is potentially liable for an estimated 205 million euro in creditor claims and 120 million euro to remedy extensive environmental damage. In addition, it will take an estimated 175 million euro of investment for Trepca to again become a profitable concern.

KOSOVO'S PATRIMONY

¶4. (SBU) Trepca remains a highly emotional issue that looms large in the popular imagination due to its past and the widely held view that it was purposely driven into the ground by Milosevic-era management. Its revitalization is seen by many as the key to Kosovo's independent economic future. Popular sentiment does not favor the KTA, or the UNMIK administration that first conceived the Chapter 11-style approach, and many Kosovar Albanians oppose giving an independent administrator control over Trepca and its fate. (NOTE: While there is every indication Kosovo could develop a productive mining industry under the right circumstances, industry sources tell us that Trepca itself would have been closed years ago if it had been a private enterprise. END NOTE.)

¶5. (SBU) On August 27, the Assembly was set to vote on a resolution that would have called on the SRSG to stop action to privatize Trepca and declare it a "strategic company of special national interest" which should operate as a publicly-owned enterprise (POE). The Assembly appeared ready to take this action, apparently ignorant that making Trepca a POE would end the moratorium and make the Kosovo government liable for hundreds of millions of euro worth in claims. Largely as a result of USOP and USAID efforts, the vote on this ill-advised resolution was postponed. We have continued meeting with the chairs of the Trade and Industry Committee, caucus leaders, and the Assembly Speaker to keep it off the agenda.

¶6. (C) Although the Assembly might have opposed the privatization of Trepca merely to win pre-election political points, we discovered that the immediate motivation behind

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the resolution was a desire among party leaders for Kosovars to be better represented in the privatization process. (NOTE: Under the regulation that governs KTA reorganizations, UNMIK 2005/48, the Special Chamber, made up of three international and two Kosovar judges, appoints an administrator to oversee Trepca's Chapter 11-style restructuring. END NOTE.) The administrator would then sort out creditor claims and privatize the assets, leaving the Kosovo government without a decision-making role. Many in the Kosovo government strongly believe that some of the debts are for money that was diverted to Belgrade's war chest and Swiss bank accounts rather than being invested in Trepca, and for that reason are loathe to repay them, at least without further litigation. In addition to our intervention with the Assembly, we met with UNMIK, which earlier did not fully appreciate the emotional importance of Trepca to local politicians. UNMIK has since agreed to negotiate amendments to 2005/48 with the PISG and give them a larger role.

¶7. (C) COMMENT: If for no other reason than to stop it from taking ill-considered steps that could potentially undermine the entire privatization process for Trepca, the PISG needs a seat at the table when decisions regarding the future of Trepca are considered. This will be challenging, as some of our local interlocutors will approach this issue from a position of political demagoguery, ill-advised economic nationalism, bad communist economics, and rent-seeking agendas. Nevertheless, our experience through USAID with Kosovo C and its project steering committee suggests that we can empower the Kosovars -- in cooperation with other stakeholders in the international community -- to be responsible stewards of such an asset. END COMMENT.
KAIDANOW